STRATEGIC INVESTMENT ALTERNATIVES FOR THE TRAVEL AGENCY SECTOR IN KENYA IN THE FACE OF A TURBULENT GLOBAL ENVIRONMENT

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ABSTRACT

The highly unpredictable and competitive environment has had a profound impact on the travel sector, with travel agents, who had a very fruitful relationship with the airlines increasingly facing reduced incomes due to the increased use of the internet by travelers and the removal of agency commissions by airlines. This has resulted in travel agency owners and managers searching for strategies to adopt in order to survive the turbulent business environment. This paper explores the alternative strategic business options available to the Kenyan travel agency owners / managers in the face of this turbulent environment and suggests the most viable for adoption. The author uses desktop research, through the International Franchise Assessment Model and Uniglobe Travel International as case to analyze the franchising as a strategic option for travel agents. The findings indicate that Kenya is an acceptable destination for franchisors to invest in and the benefits of Kenyan travel agents adopting franchising as a business model are enormous making it the best option for them. The study recommends the create of awareness about franchising in the country, the enactment of a franchising law to guide and regulate the business and promote the development of the franchising business in the country.

Key Words: *Tourism, Franchise, Strategy*

Introduction

The tourism industry is one of the fastest growing sectors of the global economy, accounting for more than one third of the total global services trade. According to Brende and Greenhill, (2013), the sector accounted for 9 percent of GDP, a total of US$6 trillion, and provided 120 million direct jobs and another 125 million indirect jobs in related industries globally in 2012. The sector has benefitted from the continuing globalization process with travel increasing in the mature markets driven by the rising purchasing power of the growing middle class in many developing economies (Blanke and Chiesa, 2013).

Despite the industry's success globally, the highly unpredictable and competitive environment has had a profound impact on the travel sector. Several factors, ranging from the increase of fuel prices and airport charges have caused an increase in the cost of travel which in turn has forced travelers to make their own travel arrangements directly with the suppliers via the internet in order to save costs (Abdul-Hamid, 2011). In the process, there has been reduced business for the traditional travel agent and a withdrawal of commissions by the airlines forcing the travel agents to look for alternative business models.

Franchising is a rapidly growing model for business expansion in the retail and services sector globally. Burrone, (2006) defines it as a contractual arrangement under which one enterprise (the franchisor), who has developed a system for conducting a particular business, allows one or more other enterprises (the franchisees) to use that system in accordance with the prescriptions of the franchisor, in exchange for a monetary consideration. According to Welsh, Alon, and Falbe, (2006) franchising has reached domestic market saturation in the US, Canada, and parts of Western Europe, while emerging markets remain relatively untapped thereby becoming the fastest growing targets for investment by international franchisors. Welsh, Alon, and Falbe, 2006). Franchising has increasingly become important part of the growing services sector of the emerging economies because of the entrepreneurial opportunities it creates and the huge potential for job creation (Pal, 2013).

The US Commercial Service observes that the franchising market in Kenya is steadily growing and evolving from single-unit owners to multi-unit operators. Several franchise companies now operate in Kenya, covering almost every industry, from well-known national brands to smaller and local opportunities but most of them are hosted by the hospitality industry (US Commercial Service, 2013).

Problem Statement

The travel sector of the tourism industry has and is still undergoing immense change resulting from global macroeconomic changes and environmental factors including periods of global recession and economic growth, changing demographics, foreign competition, the deregulation of the airline industry and new technologies such as the Internet (Osborne, Nagendra and Falcone, 2001). These changes, according to them, are manifest in the increase of discount airlines, the increasing consolidation of airlines (e.g., United and US Airways) to form strategic alliances and more recently, the dilution of the traditionally symbiotic relationship between the airlines and travel agents which resulted in the airlines removing the commissions previously paid to the agents.

The result of the weakening of the airline – travel agency relationship has been a paradigm shift in the role of travel agencies, whereby they are moving from being the distribution arm of the suppliers (e.g. airlines) to become the purchasing arm of consumer. This shift has seen an increasing need for travel agency managers to seek appropriate strategy in order to survive the new order thus this research.

Research Objective

The objective of this paper was to explore the alternative strategic options available to the Kenyan travel agency managers in this turbulent business environment and suggest the most viable for adoption.

Research Methodology

Qualitative research methodology was used in this paper. The author used the international Franchise assessment model on a case to analyze the franchising as a strategic option for travel agents. According to Yin, (1994), case study research is a very useful method as it allows expanding and generalizing of theories by combining the existing theoretical knowledge with new empirical insights. This is especially important in studying topics that have not attracted much previous research attention.

Literature Review

As indicated earlier, travel firms are being increasingly confronted with an assortment of changes in the business environment which require innovative strategies by travel agency managers that can enable them to buffer their organizations from perceived environmental threats and enable them to exploit developing opportunities (Abdul-Hamid, 2011). There are various strategic options available to the travel agency managers, some of which are examined below.

General Strategic Alternatives

Galbraith (1977) proposes three sets of proactive strategies for the management of the business environment under which travel agents operate. These include: independent strategies, cooperative strategies, and strategic maneuvering. According to Abdul-Hamid, these strategies can reduce an organization's dependency on external entities and could therefore be beneficial to travel agencies, which are dependent upon the airlines and other travel suppliers because of their roles in the channel of distribution.

Independent strategies are employed by an organization to modify its competitive environment, for example by differentiating its products, thereby gaining a greater measure of control over the environment. These strategies are more appropriate for an organization that experiences low to medium levels of uncertainty and dependency (Galbraith, 1977). By operating independently, the organization maintains its autonomy from other organizations while still being proactive. These strategies include competitive aggression, dependency development, smoothing, de-marketing and political action.

Strategic maneuvering is a strategy in which the organization attempts to alter the task environment rather than managing the environment. It involves assessing the change desired and evaluating the risk and as a result, taking more extensive steps to reduce or eliminate such dependency, by for example, creating a new or unique market niche. Strategic maneuvering can be conducted in several ways, such as merger and acquisitions, strategic alliances, diversification and domain selection (Galbraith, 1977).

The third of Galbraith's (1977) strategies is the cooperative strategies. These involve organizations joining together in an agreed manner to strengthen their relative position and to diminish or minimize their dependence on an environment by developing countervailing power. Examples of cooperative strategies include coalitions, contracting or franchising.

From the business owner's perspective, independent strategies may require a large outlay of cash in order to operationalize, while strategic maneuvering may involve a total loss of ownership or surrender of independence by the business owner. Franchising on the other hand offers the owner the advantage of belonging to a large chain, while at the same time being an independent business person (Hunt, 1997). Training, operational assistance, independence, an established brand image, national promotion, and reduced risk are also thought to be important considerations for joining a franchise (Mendelsohn, 2004). Additionally, several benefits of franchising have been identified and include lower development costs, established name, lower operating costs, less involvement, greater independence, better investment and training (Weaven and Frazer, 2006).

Theoretical Background

According to Azibadeh, (2010), capital constraint and agency theory can help to explain why franchisors undertake franchising, and efficiency incentives suggest why franchisees are motivated to maximize their efforts. The foundation of agency theory is the concept of principal-agent relationship, where the principal delegates work to the agent who performs it on a day-to-day basis. Agency theory can therefore be used in the context of principal – agent relationship to highlight the importance of information transfer process and information asymmetry problem (Arrow, 1962) in franchises. This can be useful in resolving issues related to the franchisor – franchisee if necessary.

On the other hand, the resource scarcity theory proposes that companies (franchisors) are motivated to franchise primarily as a means of raising capital (Oxenfeldt and Kelly, 1968) and because of the need for information and managerial resources (Michael, 2002). The franchisees therefore bring to the franchise system financial capital, market knowledge and labour (Dant and Kaufmann, 2003) in exchange for the operational assistance, brand image, national promotion, training, and reduced risk that the franchisor provides.

Conceptual Model

This paper uses the International Franchise Assessment Model designed by Aliouche and Schlentrich (2009) in order to identify an established tool that can be used to evaluate the ideal conditions necessary for foreign franchisors to enter into franchise arrangements with Kenyan travel agents.

According to Aliouche and Schlentrich (2009), two major perspectives impact a firm's decision to enter or expand in a foreign market: (1) the external macro-environment of the proposed host country, and (2) the internal micro-environment of the franchise system. In addition, franchise firms also need to conduct a strategic and financial assessment of the proposed international opportunity in order to choose the optimal entry/expansion mode.

The International Franchise Assessment Model is hierarchical in nature and is divided into three sections (see annexed figure 1). Section One assesses the external macro-environment of the targeted country and is comprised of three measures: market risk, market potential, and distance. Section Two assesses the internal micro-environment of the franchise system using measures such as the product and service concept, operations and management, staffing requirements, site and physical plant, supply chain needs, and infrastructure requirements. Section Three assesses financial factors such as capital requirements (equity and debt), unit profitability, return on investment, and the long-term viability of the proposed entry or expansion in a foreign location. This financial assessment is a key factor determining the selection of the optimal strategic entry and/or expansion mode(s) by the franchisor (Aliouche and Schlentrich, 2009).

The Franchise Case Study: Uniglobe Travel International

Uniglobe Travel International is a leading international travel management system specializing in providing travel services to small and mid-size enterprise (SME) and leisure clients through its network of franchised and member agencies. The Uniglobe organization presently comprises locations in more than 60 countries across the Americas, Europe, Asia/Pacific, Africa and the Middle East operating under a well-recognized brand, common system and services standards. It has its world headquarters in Vancouver, British Columbia, Canada (Uniglobe international, 2013).

Uniglobe Travel International operates under a master-franchising structure, where it is the owner of all rights, trademarks, and systems of the Uniglobe program. The franchisor awards Regional Master Franchise Licenses to business leaders worldwide who develop and expand the Uniglobe brand and help them to build successful travel management companies. The innovative Global Partner program allows eligible travel management companies or business travel agencies around the world to take advantage of the Uniglobe network (Uniglobe international, 2013).

External Macro-environment

The external environment comprises of factors identified as important for international franchise expansion which are (1) market risk consisting of political, economic, legal and regulatory factors; (2) market potential involving population and income factors, and (3) distance consisting of geographic and cultural factors (Aliouche and Schlentrich, 2009).

In order to assess political and economic risk, one can use data that captures a country's political and economic risk. For example, Aliouche and Sclentrich, (2009) suggest the use Euromoney, which publishes country ratings twice a year and computes a composite country risk score using a weighted average on nine different risk dimensions - political risk, economic performance, debt indicators, debt in default or rescheduled, credit ratings, access to bank finance, access to short-term markets, access to capital markets, and forfeiting.

To assess each country's legal and regulatory risk, Aliouche and Sclentrich, (2009) use the Ease of Doing Business Index developed by the World Bank. It captures most of the critical legal and regulatory risks involved in operating a business in a given country. Countries are ranked based on the ease of starting a business, dealing with licenses, employing workers, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, and closing a business.

Considering the fact that not all of the above data exists for Kenya in the World Bank and Euromoney indexes, the author obtained some data from the these sources but resorted to a general description of the political and economic conditions in the country using data from other sources for purposes of assessing the country’s political and economic risk.

According to the World Bank, Kenya is considered a low income nation with a population of 43 Million which is relatively young and is becoming increasingly urbanized. It averages 5% GDP growth, largely because of expansions in tourism, telecommunications, transport, construction and agriculture. Kenya has a market based economy with a liberalised foreign trade policy. The government, generally perceived as investment friendly, has enacted several regulatory reforms to simplify both foreign and local investment (US Commercial Service, 2013).

The following is an assessment of Kenya’s suitability as a franchise destination using the World Bank’s Ease of Doing Business Index (2013) and the Euromoney Index (2013):

1. *Ease of doing business*: The index averages the country’s percentile ranking on 10 topics covering several aspects of business. The countries are then ranked in order of business friendliness from 1 – 189. In 2012, Kenya was ranked number 122 out of 189 overall. In comparison, Uganda was ranked 132/189, Tanzania 145/189, while USA was ranked 4 / 189 and the UK 10 / 189.

2. *Availability of domestic credit to the private sector*: refers to the financial resources provided to the private sector, such as loans, non-equity securities, trade credits and other accounts receivable measured as a percentage of GDP. Kenya scored 36.6%, compared to Uganda (16.3%), Tanzania (17.9%) and the US (19.4%).
3. *Start-up procedures:* This is a measure of the number of procedures one undergoes in order to register a business, including interactions to obtain necessary permits and licenses and to complete all inscriptions, verifications and notifications before starting operations. In 2012, Kenya had 10 procedures compared to Uganda (15), Tanzania (9), US (6) and UK (6).
4. *Time required starting a business:* this is the number of calendar days needed to complete the requisite procedures before legally operating a business. In 2012, one needed 32 days in Kenya and Uganda compared to 26 days in Tanzania and 12 days in the UK and 5 days in the US.
5. *Commercial / Business tax rate:* measures the amount of taxes, mandatory contributions payable by businesses after accounting for allowable deductions and exemptions as a percentage share of commercial profits. In 2012, Kenya had the third highest tax rate at 44.2% when compared to Tanzania (44.9%), Uganda (36.6%) USA (46.3%) and UK (34.0%)

Other economic and business indicators obtained for Kenya were the Extent to which investors are protected through disclosure of ownership and financial information (Business disclosure index) where Kenya scored 3.0 out of 10.0 (0 = less and 10.0 = more disclosure); It was also rated 106th overall in the economic freedom index (Euromoney, 2013).

There are being no specific franchise laws in Kenya, investors in the franchise industry must rely heavily on existing commercial laws and various applicable business laws to establish themselves. These include: (1) Common Law (2) Law of Contract Act of 2002 (revised 2012) (3) the Copyright Act of 2011 and (4) The Trade Marks Act (Cap. 506) makes specific provisions for the “recognition of license user agreements” and most franchisors have exploited this legal avenue (US Commercial Service, 2013). The existence of such laws would make the relationship clearer and advise on conflict resolution methods.

The cultural distance (i.e., difference in the culture and language of the host and home countries) and the geographic distance add further complexity and risk to franchising in a foreign country. In general, franchisors favor markets that are culturally and geographically closer to the home country than those that are further away. The very strength of the franchise format, its standardization, makes its successful replication in foreign markets difficult if cultural distance is great (Aliouche and Sclentrich, 2009). This does not present a major problem, especially for business with the Western economies, considering the relatively high literacy rate in Kenya, the languages spoken (English and French). The geographical distance can be overcome through technology.

In terms of market potential, the franchise business model has been slow to take hold in Kenya because local investors know little or nothing about its potential rewards (US Commercial Service, 2013). However, American franchises such as KFC and Naked Pizza and South African ones including Chicken-Inn, Pizza-Inn, Creamy Inn and Galitos have are well established in the larger cities like Nairobi and Mombasa. In terms of travel and tourism services, the potential on domestic and outbound international travel is high considering the growing middle class in Kenya. In addition, there is potential for increased consumption of travel and tourism products from within the East African Community and the IGAD regions considering the increase in integration activities in the two regions.

Internal Micro-environment

Uniglobe employs Business Format Franchising, which is a system of marketing goods and/or services and/or technology based upon a written contract between two legally, financially and fiscally separate and independent undertakings, the Franchisor and each of its individual Franchisees, whereby the Franchisor grants each of its individual Franchisee the right, and imposes the obligation, to conduct a business in accordance with the Franchisor's concept (European Franchise Federation, 2011).

In agency theory, it is assumed that agents are motivated by self-interest, are rational actors, and are averse to taking risks (Eisenhardt, 1989). This assumption could be the genesis of franchisor – franchisee relationship problems. Part of the problem is that there are two distinct business interests in a franchise arrangement - the franchisor who owns the trading name, patents, copyrights and the license to franchise the business system to others and the individual entrepreneur who invests in the brand by purchasing the right to operate under the trading name as a licensed franchisee (Davis, 2012).

The first is information asymmetry (hidden information) where the principal is not aware of if a prospective franchisee weaknesses and whether they have the desired characteristics that the principal is seeking (Axelrad and Rudnick, 1987, Spake et al., 1999). The second issue is moral hazard (hidden action) and occurs after the contract has been sealed when a franchisee fails to perform at the expected level (Brickley et al., 1991, Thomas et al., 1990) (cited in Bennette, Frazer and Weaver, (2009).

Franchisors attempt to overcome these two problems by implementing incentive-based contracts (Lafontaine and Slade, 1998). Choosing plural forms of operation (a mixture of franchised and company owned units) is often adopted by franchisors and minimises the possibility of free riding by franchises (Blair and Lafontaine, 2005). Therefore, principals can motivate agents through controlling their incentives (Gomez-Mejia and Balkin, 1992)

Barriers to the growth of Franchising in the travel sector Kenya

In their study on franchising in Croatia, Alon, Alpeza and Erceg (2007) identified five barriers to the development of franchising, which quite clearly fit the current situation in Kenya:

1. Lack of legal regulation of franchising. The absence of clear legal precedent makes it difficult for franchisor and franchisee lawyers to help their clients, especially during the contracting phase and when there are
2. Shortage of infrastructure related to franchising: there are few franchise consultants who may be needed to help potential franchisors in developing their businesses and networks. In addition, franchisors or franchisees sometimes need banks that are willing assist them establish their business, but are unable to get any that understand the franchise business.
3. There is not enough education about franchising in the country, resulting in potential franchisors and franchisees not knowing where to go and who to contact if they want to find out more about franchising and how it can work.
4. Franchising needs both the domestic and international markets in order to survive. Countries in Africa in general have small travel and tourism source markets, perhaps as a result of the harsh economic conditions, which do not encourage travel for leisure. Many travel agencies therefore rely on the corporate travelers and the few upper and middle class travelers to survive.
5. Franchising is not a well-known way of doing business. This is perhaps the biggest barrier to the growth of franchising since people do not know what it is and as a result they are not willing to enter into something with which they are unfamiliar.

The way forward to the Strategic Investment Alternatives

In order to encourage the growth of franchising in Kenya it is necessary to create a conducive environment and incentivize franchising relationships in the country. Alon, Alpeza and Erceg (2007) suggest the following, amongst others, in which the government and private sector can stimulate franchise growth and development:

1. Create awareness about franchising – organizing seminars, workshops and use different types of media in order to educate entrepreneurs about franchising and its benefits;
2. Enact a franchising law to guide the establishment of and to regulate franchising in Kenya.
3. Help domestic companies to become franchisors – organized training for potential franchise consultants who can help domestic companies if they decide to use franchising as a growth strategy;
4. Form a Franchising Association – both Centers and the Association are trying to promote franchising as a way of doing business through local media – interviews, articles in the newspapers and magazines, et al.

Conclusions and Recommendations

Franchising is one of several possible models for business growth and is widely used in economically developed countries throughout the world. Some of the reasons why companies prefer to develop franchise networks rather than creating subsidiaries include lower financial investment, lower risk, faster growth, and local market knowledge by franchisee; and the franchisee's motivation to succeed. Given the various strategy options for travel agents in developing countries to combat the fast-changing and uncertain business environment, franchising is the best.

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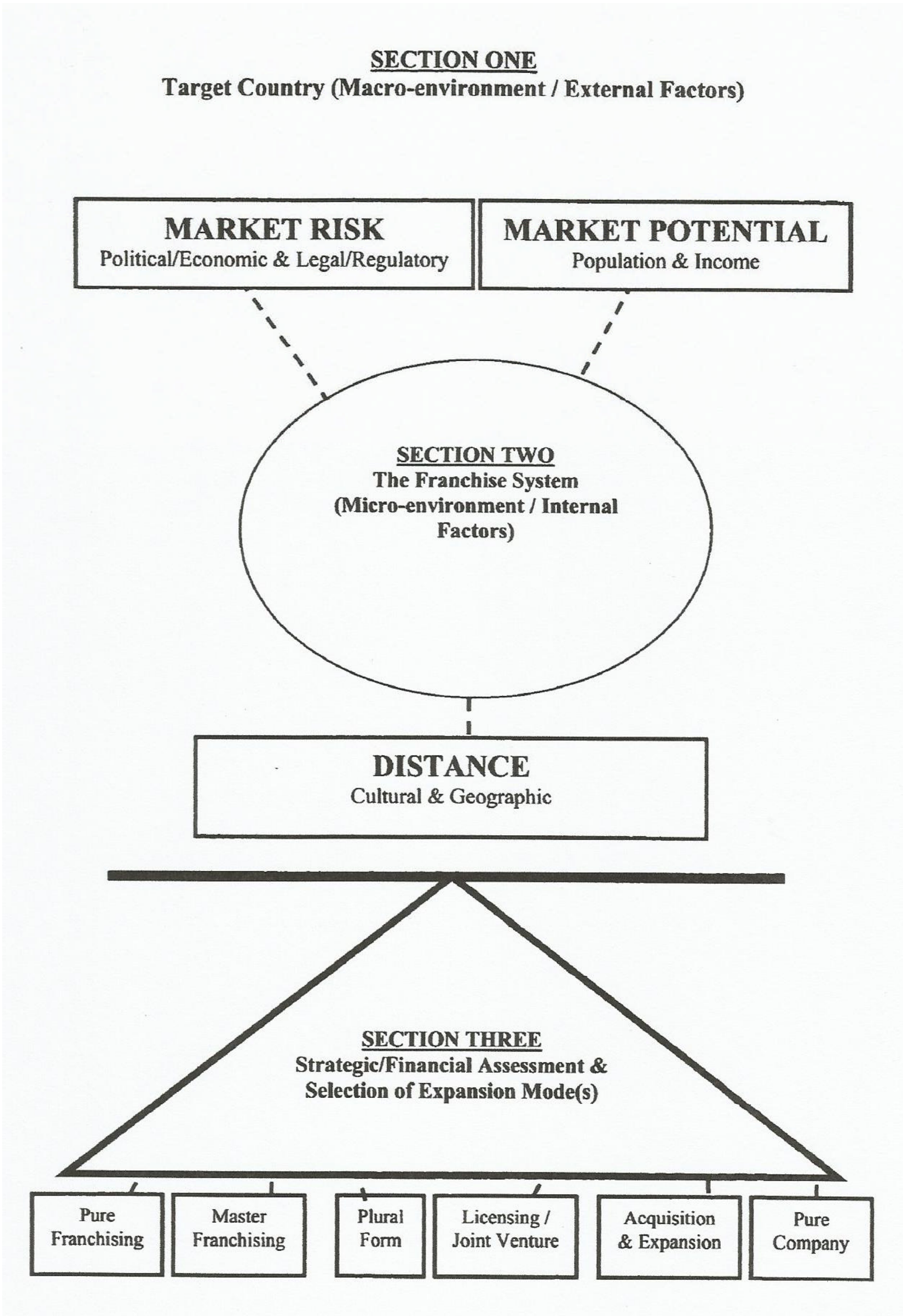
Appendix

Figure 1: Conceptual Framework



Adapted from (Aliouche and Schlentrich, 2009)